
Board of Investment Trustees



Montgomery County Employee Retirement Plans

Annual Report –Fiscal Year 2005

Overview

November 30, 2005

To: Employees, Retirees, and Beneficiaries

From: Board of Investment Trustees

The mission of the Board of Investment Trustees is to manage prudent investment programs for the members of the Employee Retirement Plans and their beneficiaries. The County's Chief Administrative Officer is responsible for overseeing the day-to-day administration of the retirement plans.

We are pleased to present this annual report for the fiscal year ending June 30, 2005 on the three investment programs established for the retirement plans.

- The Employees' Retirement System (ERS) is a defined benefit pension plan with assets of \$2.14 billion, established in 1965 and closed to employees hired on or after October 1, 1994, except public safety bargaining unit employees. As of June 30, 2005 the ERS had 5,628 active participants and 4,665 retirees and beneficiaries receiving benefits.

- The Retirement Savings Plan (RSP) was established in 1994 as a defined contribution plan providing benefits to all non-public safety and certain public safety employees hired on or after October 1, 1994. As of June 30, 2005 the RSP had \$71.2 million in assets and 3,941 participants.

- The County Deferred Compensation Plan (DCP) is a voluntary plan established pursuant to Section 457 of the Internal Revenue Code. As of June 30, 2005 the DCP had \$187.5 million in assets and 3,951 participants.

Shown below is a condensed presentation of the Net Assets and Change in Net Assets from the Comprehensive Annual Financial Report for the retirement plans for the period ending June 30, 2005:

Net Assets (Millions)						
	ERS		RSP		DCP	
	2005	2004	2005	2004	2005	2004
Assets:						
Cash and investments	\$2,406.4	\$2,268.1	\$ 70.4	\$ 54.9	\$ 186.7	\$ 239.9
Receivables	11.9	10.5	0.8	0.7	0.8	1.1
Total assets	2,418.3	2,278.6	71.2	55.6	187.5	241.0
Liabilities	273.5	303.0	-	-	-	-
Total net assets	\$2,144.8	\$1,975.6	\$ 71.2	\$ 55.6	\$ 187.5	\$ 241.0

Change in Net Assets (Millions)						
	ERS		RSP		DCP	
	2005	2004	2005	2004	2005	2004
Additions:						
Employer contributions	\$ 74.7	\$ 61.9	\$ 8.7	\$ 6.5	\$ -	\$ -
Member contributions	15.3	14.8	4.8	4.2	19.9	21.6
Net investment income	197.4	286.9	4.7	6.3	14.6	29.4
Total additions	287.4	363.6	18.2	17.0	34.5	51.0
Deductions:						
Benefits	115.6	111.6	-	-	-	-
Refunds	0.8	0.8	2.4	1.4	10.2	9.6
Administrative expenses	1.8	2.1	0.2	0.2	-	-
Movement of member account asset balances	-	-	-	-	77.8	-
Total deductions	118.2	114.5	2.6	1.6	88.0	9.6
Total change in net assets	\$ 169.2	\$ 249.1	\$ 15.6	\$ 15.4	\$ (53.5)	\$ 41.4

For detailed information on all three retirement plans, please visit the Board's web site at www.montgomerycountymd.gov/bit. For questions, please call the Board office at 240-777-8220.

Board of Investment Trustees

Stephen B. Farber
Chair

Montgomery County Council Staff Director
Ex-Officio Member

Arthur W. Spengler
Vice Chair

Retired Employees Representative
Term Expires March 2006

Sandra P. Kaiser
Secretary

Montgomery County
Department of Permitting Services
Non-Bargaining Unit Representative
Term Expires March 2008

Mark A. Barnard

Montgomery County Council Representative
Term Expires March 2006

Joseph Adler

Montgomery County Director
Of Human Resources
Ex-Officio Member

Timothy L. Firestine

Montgomery County Director of Finance
Ex-Officio Member

Beverley Swaim-Staley

Montgomery County Director of
Management and Budget
Ex-Officio Member

Cora M. Ingram

Montgomery County Council Representative
Term Expires March 2008

Sharon M. Cayelli

Citizen Representative
Term Expires March 2008

Gino Renne

Employee Organization Representative
Term Expires March 2007

Kelda J.C. Simpson

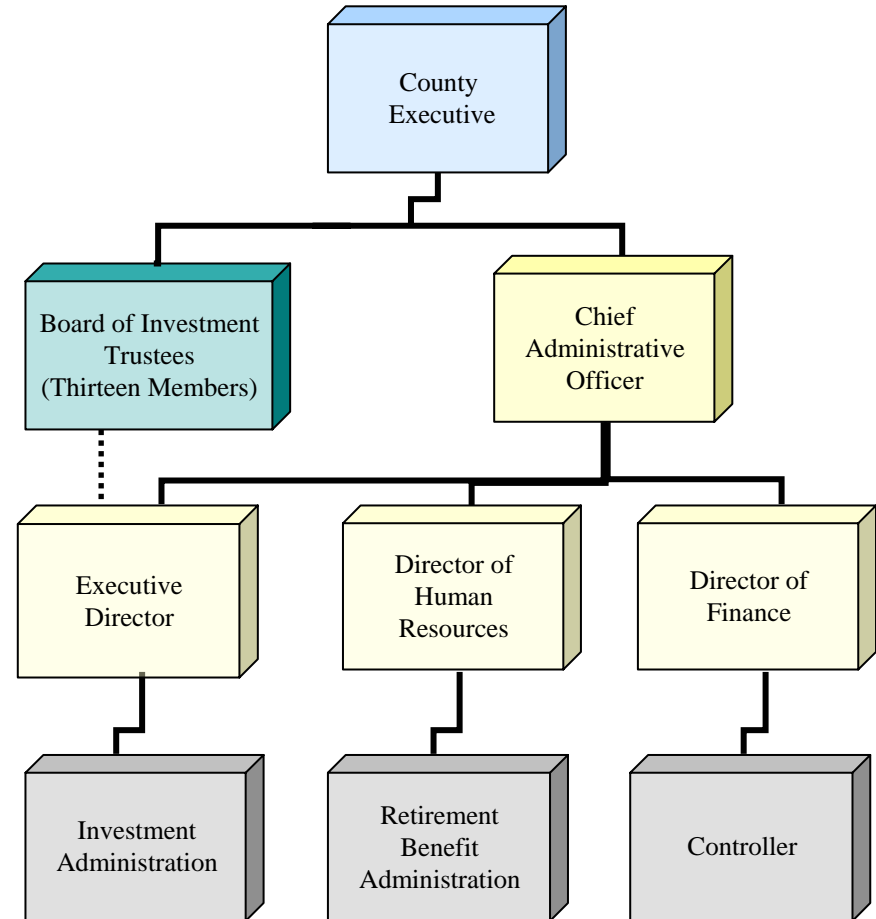
Citizen Representative
Term Expires March 2008

Jeffrey D. Buddle

Employee Organization Representative
Term Expires March 2008

Walter E. Bader
Employee Organization Representative
Term Expires March 2008

Retirement Plans Organization



Board Actions During FY 2005

■ ***Employees' Retirement System***

- *Completed an asset/liability study of the plan, which includes an evaluation of the risk/return efficiency of the current asset mix to meet the future projected growth of plan liabilities. As a result of the study, the Board began reviewing the potential of adding investments within the real estate asset class and expanded the investments within the alternatives asset class by hiring a private equity secondary fund-of-funds manager.*
- *Established commission rebate program to lower overall trading expenses.*
- *Amended the risk management program to actively manage the inherent risks associated with the investment process to achieve the highest possible risk adjusted return.*

■ ***Retirement Savings Plan***

- *Conducted a structural review of the fund offerings, resulting in the addition of five new funds: Artisan Small Cap, Fidelity Real Estate, Templeton World, Fidelity Managed Income Portfolio, and Fidelity Inflation Protected Bond. Four funds were eliminated due to relative performance or duplication of other fund offerings.*
- *Continued to expand outreach efforts to advise plan participants of the availability of free investment counseling service.*

■ ***Deferred Compensation Plan***

- *Held annual benefit fair with representatives from each fund family available to respond to participant questions and to provide information on their fund options.*
- *Continued to offer bi-weekly investment seminars to provide participants with information on a variety of investment topics. CitiStreet also held brownbag luncheon seminars at different locations in the County to educate participants on the benefits of the program.*

Board Achievements

■ ***Certificate of Achievement for Excellence in Financial Reporting***

- *The Government Finance Officers Association (GFOA) awarded the Certificate of Achievement to the Board for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2004. The certificate of achievement is a prestigious national award that recognizes conformance with the highest standards in government accounting and financial reporting. The Board has received this award for each of the five years that it has published its own CAFR.*

■ ***Employees' Retirement System***

- *The ERS achieved an investment return of 10.09% (after management fees) for the year ended June 30, 2005. The ERS return ranked in the top 25 percent, or better than 75 percent, of returns achieved by similar public pension funds reporting results.*

■ ***Retirement Savings Plan***

- *Amended the provider contract to include expanded services and elimination of the administrative fee.*

■ ***Deferred Compensation Plan***

- *As of June 30, 2005 over 50% of the funds offered through CitiStreet are rated as four- or-five star funds by Morningstar (five star is the highest rating).*

Current Board Initiatives

■ ***Employees' Retirement System***

- *Continue to review the investment portfolio to evaluate the risk of each investment manager/sector versus its contribution both in return and in diversification to the ERS' portfolio.*
- *Analyze the feasibility of adding new investment sectors, including currency management, real estate, commodities, and hedge funds, to the Plan's portfolio.*

■ ***Retirement Savings Plan***

- *Review the mutual funds offered to participants to ensure that a diversified slate of top quality funds is available at the lowest possible fee.*
- *Continue to expand investment education programs by:*
 - *Notifying participants quarterly of the availability of free annual investment counseling sessions with a feature of the program, investment options, or financial markets being highlighted each quarter.*
 - *Encouraging directors to sponsor "brown bag lunches" to elevate awareness of the investment counseling program.*

■ ***Deferred Compensation Plan***

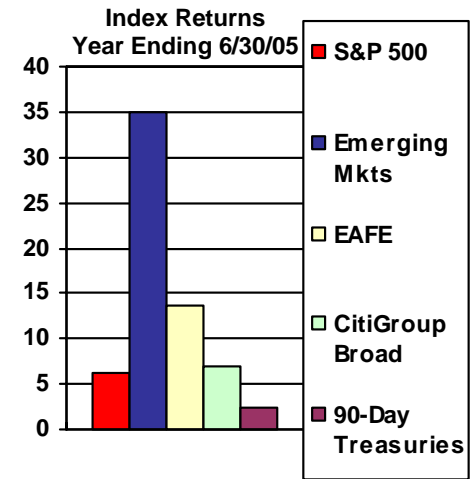
- *Continue to evaluate the investment program to ensure that fund offerings are among the best performers, as measured by an independent source, have the lowest cost, and are managed by strong companies in compliance with regulatory agencies.*
- *Expand investment services to help participants receive information quickly and easily, increase their knowledge of investment matters, and receive support in retirement planning.*

Market Highlights – ERS Investment Performance

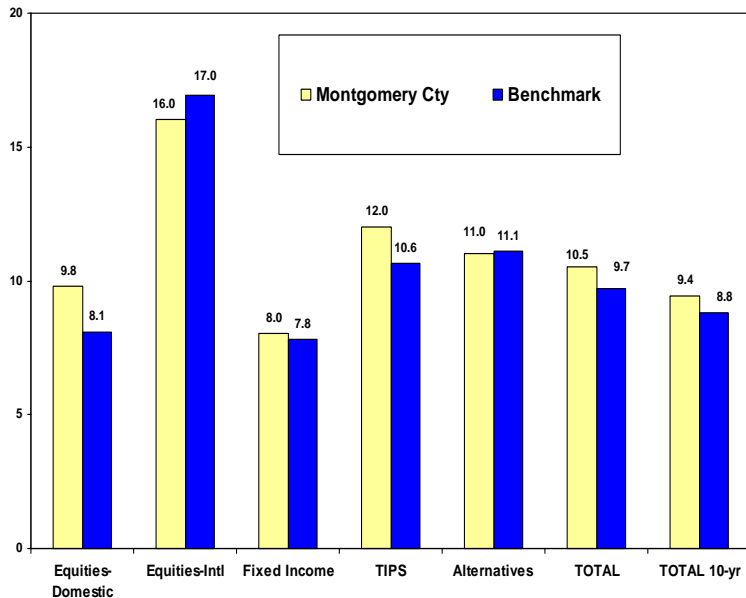
As shown in the chart to the right, stock market returns for the year ending June 30, 2005 were mixed. The best performing sectors were international (measured by the EAFE Index), up 13.7%, and emerging markets, gaining nearly 35%. The best performing stocks within the U.S. stock market were the mid-to-small capitalization companies. The Standard & Poor's 500 Index was up 6.3%, with the utilities sector of the index recording a 37.7% return.

Within the fixed income sector, high yield bonds (below investment grade bonds) returned 10.4% compared to the 7% return of the CitiGroup Broad Market Index (representing the overall bond market). Long-term interest rates were historically low due to the lack of volatility and strong foreign demand for U.S. fixed income instruments.

The Federal Reserve raised the short-term interest rate nine times during the year to 3.25% in an attempt to tame inflation pressures. The view of most investment managers is that the Federal Reserve will continue to gradually increase interest rates in "measured" steps, evaluating the strength of employment growth, expansion of the economy, and inflation indicators.



Employees' Retirement System FY 2005 Returns by Asset Class-Gross of fees



The Board allocates ERS assets to a broad array of investment sectors as follows: domestic equities 45%, alternative investments 5%, international equities 15%, domestic fixed income 25%, and Treasury Inflation Protection Securities 10%. The chart to the left reflects the returns for the fiscal year ending June 30, 2005 achieved by the ERS assets in each investment sector compared to the corresponding benchmark. The Board establishes benchmarks for each market sector, usually an index of companies that represent most of the available investment opportunities within that sector, to evaluate the performance of the investment managers within each sector.

In overseeing the management of ERS assets, the Board has developed sound and prudent investment policies. The Board works to control the risk to which the ERS is exposed while maximizing the potential for long term increases in the value of the assets. The Board's specific investment objectives are to:

- realize the actuarial assumed rate of return of 8 percent annually, over a long term time horizon (for the 1996-2005 fiscal year decade, the annual rate of return on the ERS' investments was 9.43% before fees);
- manage portfolio risk to limit potential downside fluctuations in the value of the total ERS assets; and
- realize as high a rate of total return as possible consistent with the above.

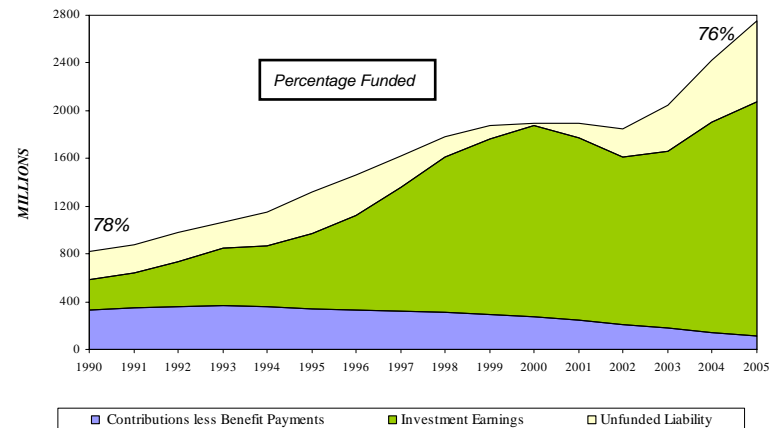
Employees' Retirement System (ERS)

- **How do I know if I'm a participant in this plan?**
 - Employees who participate in the ERS have the following description on their pay stub next to the bi-weekly contribution amount: *RETIRE*
- **How is my benefit calculated?**
 - Under County law your benefit is based on your salary, years of credited service, and age at retirement and is not based on the amount you contributed or the investment earnings of the ERS.
- **How can I find more information on my benefit?**
 - Contact the Office of Human Resources at 240-777-5120.
- **How does the amount earned on invested assets impact the ERS?**
 - While your ERS benefit is paid in accordance with County law, you may be interested in knowing about the status of the assets and liabilities of the ERS. Please refer to the chart to the right for a 15-year history. Your contributions, along with the County's, are used primarily to make benefit payments to retirees and beneficiaries and pay other costs associated with the administration of the ERS (shown as the bottom layer in the chart).

The earnings (shown as the solid middle layer in the chart) represent the bulk of the growth in assets over the years. In funding the ERS, the County assumes the assets will earn 8% per year. During the strong equity markets of the late 1990s, the assets grew at nearly double that amount, and the funded status of the ERS was strengthened.

As of June 30, 2000 the ERS was nearly fully-funded, but because of the difficult financial markets in 2000-2002 and increased liabilities for higher future benefit payments, the funded status has decreased. As of June 30, 2005, the ERS was 76% funded. The area shown as the top layer reflects the additional amount required for the ERS to achieve fully-funded status. As noted earlier, the Board continues to implement sound and prudent investment policies that will maximize the potential for long-term increases in the value of the assets.

GROWTH IN PLAN ASSETS VS. LIABILITIES



Retirement Savings Plan (RSP)

The County established the Retirement Savings Plan for all non-public safety and certain public safety employees not represented by a collective bargaining agreement hired after October 1, 1994. The Plan requires employees to contribute 3% of regular earnings up to the Social Security wage base and 6% above the wage base. The County contributes 6% and 10% of regular earnings for non-public safety and some public safety employees, respectively.

■ How do I know if I'm a participant in this plan?

- Employees who participate in the RSP have the following description on their pay stub next to the bi-weekly contribution amount: RET SAV.

■ How is my retirement benefit calculated?

- Your benefit is based on your account balance at the time of retirement or separation of service. The balance includes your contributions, the County's contributions (if you're vested), and investment earnings.

■ How can I find out more information on my account balance and benefit eligibility?

- Contact Fidelity Investments at 1-800-343-0860 or visit their web site at www.fidelity.com.

The Board oversees the investment program, providing a variety of mutual fund options for participants to choose from. The Board evaluates the performance of the funds offered quarterly.

The Board also provides two hours of investment counseling annually to all participants at no charge, as well as group sessions, to encourage participants to expand their knowledge of investment products. Call 1-800-999-9722 to sign up.

Shown to the right is a list of the investment funds offered, along with their Morningstar rating and annualized performance as of June 30, 2005.

Fidelity's web site, www.fidelity.com, is an invaluable source of information. The web site contains:

- Your RSP account activity
- Analysis and performance information on all of the funds offered and information on investment markets
- Financial tools to assist you in determining the amount you'll need at retirement

	Funds	Morningstar Rating	Rates of Return		
			1 Year	5 Year	10 Year
Short-Term Funds:					
	Fidelity Retirement Money Market	not rated	1.88	2.40	3.89
Income Funds:					
	Fidelity Capital & Income	★★★★	14.15	6.60	8.11
	Fidelity Intermediate Bond	★★★	4.85	6.80	6.16
	Fidelity U.S. Bond Index	★★★★	6.75	7.44	6.80
Balanced Funds:					
	Fidelity Puritan	★★★★	6.46	5.43	9.28
Life-Cycle Funds:					
	Fidelity Freedom 2000	★★★	4.84	2.59	n/a
	Fidelity Freedom 2005	not rated	6.39	n/a	n/a
	Fidelity Freedom 2010	★★★	6.50	1.89	n/a
	Fidelity Freedom 2015	not rated	7.06	n/a	n/a
	Fidelity Freedom 2020	★★★	7.39	0.21	n/a
	Fidelity Freedom 2025	not rated	7.44	n/a	n/a
	Fidelity Freedom 2030	★★★	7.67	(0.91)	n/a
	Fidelity Freedom 2035	not rated	7.95	n/a	n/a
	Fidelity Freedom 2040	★★★★★	7.95	n/a	n/a
	Fidelity Freedom Income	★★★	4.38	3.32	n/a
Growth & Income Funds:					
	Fidelity Equity-Income	★★★	6.18	4.55	10.15
	Fidelity Growth & Income	★★★★	5.49	(1.45)	9.27
	Spartan Extended Market Index	★★★	13.47	1.65	n/a
	Spartan Total Market Index	★★★	8.10	(1.41)	n/a
	Spartan U.S. Equity Index	★★★★	6.25	(2.50)	9.75
Growth Funds:					
	Fidelity Contrafund	★★★★★	11.94	2.58	12.05
	Fidelity Growth Company	★★★	5.87	(7.58)	10.11
	Fidelity Low-Priced Stock	★★★★★	16.47	18.70	16.62
	Fidelity Small Cap	★★★	6.56	7.34	n/a
	Fidelity Magellan	★★	3.89	(4.24)	7.55
	Fidelity OTC	★★	2.68	(10.36)	8.39
	Fidelity Value	★★★★	16.39	14.67	12.71
International Stock Funds:					
	Fidelity Diversified International	★★★★★	14.85	5.03	12.31
	Fidelity Emerging Markets	★★	36.58	5.50	(0.32)
	Spartan International Index	★★★	12.54	(0.83)	n/a

Deferred Compensation Plan (DCP)

The County established the Deferred Compensation Plan for employees in 1980. In June 2004, the Board selected CitiStreet to provide mutual and commingled fund investment vehicles for participants. The Board evaluates the investment performance of the funds offered quarterly. Shown below is a list of the funds available as of June 30, 2005, along with their Morningstar rating and annualized performance as of June 30, 2005. Additional information on the investment program is available on the Plan web site at <http://montgomerycountymd.csplans.com> and the Board's web site at www.montgomerycountymd.gov/bit.

■ How do I know if I'm eligible to participate in this plan?

- Non-represented employees are eligible to join the DCP at any time. Employees who are members of MCGEO, and were hired prior to March 1, 2004, may also join the plan at any time. MCGEO members hired after March 1, 2004 are not eligible to participate. Employees represented by the FOP or the IAFF are not eligible to make contributions to the DCP.

■ How is my retirement benefit calculated?

- Your benefit is based on your account balance at the time of retirement or separation of service. The balance includes your contributions and investment earnings.

■ How can I find out more information on my account balance and benefit eligibility?

- Contact the CitiStreet onsite representative at 240-777-5054 or stop by the CitiStreet Office located in the Executive Office Building, Office of Human Resources, 101 Monroe Street, 7th floor. Additional information is also available at the CitiStreet website <http://montgomerycountymd.csplans.com>.

	<u>CitiStreet</u>		Rates of Return		
			1 Year	5 Year	10 Year
	Funds	Morningstar Rating			
Short-term Funds:					
	SEI Stable Asset	not rated	3.81	4.42	5.02
Income Funds:					
	Fidelity Inflation-Protected Bond	★★★★★	9.09	n/a	n/a
	Goldman Sachs Short Gov't Fund	★★★	1.66	4.84	n/a
	Hartford Bond	★★★★★	7.22	8.13	7.26
	PIMCO High Yield	★★★★	11.83	7.35	7.68
	SSgA Passive Aggregate	not rated	6.50	7.08	n/a
Life-Cycle Funds:					
	BGI Lifepath Retirement	★★★	7.07	4.49	6.3
	BGI Lifepath 2010	★★★	7.48	2.57	7.44
	BGI Lifepath 2020	★★★	7.98	0.76	8.02
	BGI Lifepath 2030	★★★★	8.47	(0.37)	8.52
	BGI Lifepath 2040	★★★	8.68	(1.90)	8.82
Growth & Income Funds:					
	Hartford Dividend & Growth	★★★	8.66	5.58	11.68
	SSgA S&P 500 Index	not rated	6.21	(2.51)	9.69
	SSgA Mid Small Index	not rated	13.46	1.00	10.27
	SSgA Tuckerman REIT	★★★	35.13	20.04	n/a
Growth Funds:					
	Smith Barney Appreciation	★★★★★	4.70	1.90	n/a
	Hartford Capital Appreciation	★★★★★	9.43	4.78	13.86
	Amer. Funds: Growth Fund	★★★★★	8.88	(0.85)	12.65
	Fidelity Low-Priced Stock	★★★★★	16.47	18.70	16.62
	Fidelity Small Cap	★★★	6.56	7.34	n/a
	Salomon Bros. Sm Cap Grwth	★★★	11.96	0.57	n/a
International Stock Funds:					
	Fidelity Diversified International	★★★★★	14.85	5.03	12.31
	Oppenheimer Global	★★★★	14.29	1.82	12.64
	SSgA daily EAFE	not rated	13.44	(0.87)	5.00